

**CABINET**  
**13 OCTOBER 2020**

---

**TREASURY MANAGEMENT ANNUAL REPORT AND OUTTURN**  
**PRUDENTIAL INDICATORS 2019/20**

---

**Responsible Cabinet Member - Councillor Charles Johnson, Resources Portfolio**

**Responsible Director - Paul Wildsmith, Managing Director**

---

**SUMMARY REPORT**

**Purpose of the Report**

1. This report provides important information regarding the regulation and management of the Council's borrowing, investments and cash-flow. It is a requirement of the Council's reporting procedures and covers treasury activity for 2019/20. The report also seeks approval of the Prudential Indicators results for 2019/20 in accordance with the Prudential Code.

**Summary**

2. The financial year 2019/20 presented similar circumstances to 2018/19 with regard to treasury management. However, as Members are aware due to the recent low returns for cash investments new ways to improve investment returns are continually being sought. Cost of borrowing remained low throughout 2019/20 and due to the Covid-19 pandemic the cost of short term borrowing is anticipated to remain low for a number of years.
3. During 2019/20 the Council complied with its legislative and regulatory requirements. The borrowing need (**Table 1**) was only increased for capital purposes.
4. At 31st March 2020 the Council's external debt was £181.661m which is £2.500m (1.3%) higher than the previous year. This relates to Housing Revenue Account (HRA) borrowing for future build requirements, that was achieved at favourable rates as the government reduced the Public Works Loan Board (PWLB) certainty rate for the HRA. The average interest rate for borrowing was down from 3.22% in 2018/19 to 2.72% in 2019/20. This reduction in the average rate of interest is due to a new mix of maturity dates to take advantage of the lower cost of borrowing for short term debt. Investments totalled £56.799m at 31st March 2020 (£55.849m at 31st March 2019) earning interest of 0.75% on short term cash investments and 2.23% on Property Fund units net of costs.
5. Financing costs have been reduced during the year and a saving of £0.268m has been achieved from the original MTFP. The majority of the savings relate to the

increase in interest received from investments and increased MRP from departmental prudential borrowing.

### **Recommendation**

6. It is recommended that:
  - (a) The outturn 2019/20 Prudential Indicators within this report and those in **Appendix 1** be noted.
  - (b) The Treasury Management Annual Report for 2019/20 be noted.
  - (c) This report to be forwarded to Council, in order for the 2019/20 Prudential Indicators to be noted.

### **Reasons**

7. The recommendations are supported by the following reasons:
  - (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities.
  - (b) To inform members of the Performance of the Treasury Management function.
  - (c) To comply with the requirements of the Local Government Act 2003.

**Paul Wildsmith**  
**Managing Director**

### **Background Papers**

- (i) Accounting Records
- (ii) Annual Investment Strategy 2019/20
- (iii) Prudential Indicators and Treasury Management Strategy Report 2019/20

Peter Carrick: Extension 5401

S17 Crime and Disorder	This report has no implications for crime and disorder
Health and Well Being	There are no issues relating to health and wellbeing which this report needs to address
Carbon Impact and Climate Change	There are no issues relating to carbon impact
Diversity	There are no specific implications for diversity
Wards Affected	The proposals affect all wards
Groups Affected	The proposals do not affect any specific group
Budget and Policy Framework	The report does not change the Council's budget or Policy framework but needs to be considered by Council
Key Decision	This is not an Executive decision
Urgent Decision	This is not an Executive decision
One Darlington: Perfectly Placed	The proposals in the report support delivery of the Community Strategy through appropriate and effective deployment of the Councils Resources
Efficiency	The report outlines movements in the national economic outlook that have enabled officers to take advantage of different types of Investments and changing interest rates to benefit the Revenue MTFP.
Impact on Looked After Children and Care Leavers	Does this report impact on Looked After Children or Care Leavers

## MAIN REPORT

### Information and Analysis

8. This report summarises:

- (a) Capital expenditure and financing for 2019/20
- (b) The Council's underlying borrowing need
- (c) Treasury position at 31st March 2020
- (d) Prudential indicators and compliance issues
- (e) The economic background for 2019/20
- (f) A summary of the Treasury Management Strategy agreed for 2019/20
- (g) Treasury Management activity during 2019/20
- (h) Performance and risk benchmarking

9. Throughout this report a number of technical terms are used, a glossary of terms can be found at the end of this report.

### The Council's Capital Expenditure and Financing 2019/20

10. The Council undertakes capital expenditure on long term assets, which is financed either,

- (a) immediately through capital receipts, capital grants, contributions and from revenue; or

(b) by borrowing.

11. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flow, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost and then optimise performance.
12. Capital Expenditure forms one of the prudential indicators that are used to regulate treasury activity. Table 1 shows total capital expenditure and how this was financed, compared with what was expected to be spent and how this would have been financed. Actual expenditure was £4.281m more than planned, mostly due to increased activity in the General Fund. However the mix of funding differs from that which was expected as some schemes progressed quicker than others. This impacted slightly on the borrowing needed to fund expenditure which was £2.559m higher than initially anticipated.

**Table 1 – Capital Expenditure and Financing**

	2018/19	2019/20		
	Outturn £m	Revised Estimate £m	Outturn £m	Variance £m
General Fund Capital Expenditure	21.298	17.280	23.111	5.831
HRA Capital Expenditure	9.376	10.834	11.963	1.129
Loans to Joint Ventures etc	6.117	10.544	7.865	(2.679)
<b>Total Capital Expenditure</b>	<b>36.791</b>	<b>38.658</b>	<b>42.939</b>	<b>4.281</b>
Resourced by:				
Capital Receipts GF	3.022	1.705	2.348	0.643
Capital receipts Housing	0.550	0.200	1.432	1.232
Capital Grants	9.336	14.753	16.705	1.952
Capital Contributions	4.076	0.000	0.162	0.162
Revenue Contributions - GF	0.000	0.000	0.956	0.956
Revenue (Housing)	9.446	10.634	7.411	(3.223)
<b>Total Resources</b>	<b>26.430</b>	<b>27.292</b>	<b>29.014</b>	<b>1.722</b>
<b>Borrowing needed to finance expenditure</b>	<b>10.361</b>	<b>11.366</b>	<b>13.925</b>	<b>2.559</b>

### The Council's Overall Borrowing Need

13. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). The figure is a gauge for the Council's debt position. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents 2019/20 and prior years' net capital expenditure which has not yet been paid for by revenue or other resources.
14. Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the government, through

PWLB, or the money markets) or utilising temporary cash resources within the Council.

15. The General Fund element of the CFR is usually reduced each year by a statutory charge to the revenue accounts called the Minimum Revenue Provision (MRP). The total CFR can also be reduced each year through a Voluntary Revenue Provision (VRP).
16. The Council's CFR for the year is shown in Table 2 and represents a key prudential indicator. The CFR outturn for 2019/20 is £219.489m which is £2.559m higher than approved due to the increased borrowing need required to finance the additional capital expenditure in 2019/20.
17. No MRP repayments were made on the General Fund debt in line with the report to Council on 23<sup>rd</sup> February 2017.

**Table 2 - Capital Financing Requirement**

	2018/19	2019/20		
	Outturn £m	Approved Indicator £m	31 March Actual £m	Variance £m
Opening Balance	198.788	207.348	207.348	0.000
Add Capital Expenditure financed by borrowing	10.361	11.366	13.925	2.559
Less MRP/VRP General Fund	0.000	0.000	0.000	0.000
Less MRP/VRP Housing	(0.629)	(0.629)	(0.629)	0.000
Less MRP/VRP PFI	(1.172)	(1.155)	(1.155)	0.000
Closing balance	<b>207.348</b>	<b>216.930</b>	<b>219.489</b>	<b>2.559</b>

**Treasury Position at 31 March 2020**

18. Whilst the measure of the Council's underlying need to borrow is the CFR, the Assistant Director of Resources can manage the Council's actual borrowing position by:
  - (a) borrowing to the CFR level; or
  - (b) choosing to utilise some temporary cash flows instead of borrowing ("under borrowing"); or
  - (c) borrowing for future increases in CFR (borrowing in advance of need, the "over borrowed" amount can be invested).
19. The financial reporting practice that the Council is required to follow (the Statement of Recommended Practice (SORP)), changed in 2007/08. Financial instruments (borrowing and investments etc.) must now be reported in the Statement of Accounts in accordance with national Financial Reporting Standards. The figures in this report are based on actual amounts borrowed and invested and so will differ from those in the Statement of Accounts which due to statutory requirements are shown at Fair Value.

20. The Council's total debt outstanding at 31st March 2020 was £181.661m. In addition to this, a liability of £11.498m relating to the PFI scheme and Finance Leases brings the total to £193.159m. The Council's revised CFR position was estimated to be £216.930m, however, the actual out turn position was £219.489m. When comparing this to our actual borrowing of £193.159m this meant that the Council was "under borrowed" by £26.330m. This "under borrowed" amount was financed by internal borrowing which means that the amount that could have been invested externally was reduced to cover this. The reduced under borrowed position still has the dual effect of reducing costs to the MTFP because borrowing costs are generally greater than investment returns and it reduces counterparty risk by reducing our exposure to banks and other financial institutions.
21. The treasury position at the 31st March 2020, including investments compared with the previous year is shown in Table 3 below.

**Table 3 – Summary of Borrowing and Investments**

Treasury Position	31 March 2019		31 March 2020	
	Principal £m	Average Rate %	Principal £m	Net annualised Average Rate %
General Debt - Fixed Rate Debt, Market and Public Works Loan Board (PWLB)	154.161	3.52%	156.661	2.93%
Property Fund Borrowing	25.000	1.17%	25.000	1.45%
<b>Total Debt</b>	<b>179.161</b>	<b>3.22%</b>	<b>181.661</b>	<b>2.72%</b>
Cashflow Investments up to 6 months	25.850	0.69%	21.800	0.91%
Capital Investments over 6 months	0.000	0.00%	5.000	1.05%
Property Fund Investment -net of costs	29.999	2.30%	29.999	2.20%
<b>Total Investments</b>	<b>55.849</b>		<b>56.799</b>	
<b>Net borrowing position</b>	<b>123.312</b>		<b>124.862</b>	

**Prudential Indicators and Compliance Issues**

22. Some prudential indicators provide an overview while others are specific limits on treasury activity. These indicators are shown below:
23. **Gross Borrowing and the CFR** – in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2018/19) plus the estimates of any additional capital financing requirement for the current (2019/20) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2019/20. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

**Table 4 – Gross Borrowing Compared with CFR**

	31 March 2019 Actual £m	31 March 2020 Approved Indicator £m	31 March 2020 Actual £m
<b>Gross Borrowing Position</b>	<b>179.161</b>	<b>183.258</b>	<b>181.661</b>
<b>PFI and Finance Lease Liability</b>	<b>12.653</b>	<b>11.498</b>	<b>11.498</b>
<b>CFR Excluding PFI &amp; leases</b>	<b>194.695</b>	<b>205.432</b>	<b>207.991</b>
<b>CFR</b>	<b>207.348</b>	<b>216.930</b>	<b>219.489</b>

24. **The Authorised Limit** – The Authorised Limit is the “Affordable Borrowing Limit” required by section 3 of the Local Government Act 2003. The Council does not have power to borrow above this level.
25. **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary are both acceptable, subject to the Authorised Limit not being breached.
26. **Actual financing costs as a proportion of net revenue expenditure** - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue expenditure. The actual for this indicator has reduced due to nil provision of MRP for the General Fund and other savings in the Financing Costs budget, but has risen from the previous year due to a reduction in the Councils overall budget.

**Table 5 – Key Prudential Indicators**

	Actual 2018/19 £m	Original Approved Limits 2019/20 £m	Revised Approved Limits 2019/20 £m	Actual Total Liabilities Borrowing + PFI/ leases 2019/20 Maximum £m
<b>Approved Indicator – Authorised Limit</b>	<b>191.814</b>	<b>326.023</b>	<b>227.776</b>	<b>193.159</b>
<b>Approved Indicator – Operational Boundary</b>	<b>191.814</b>	<b>310.498</b>	<b>194.756</b>	<b>193.159</b>
<b>Financing costs as a percentage of net revenue expenditure</b>	<b>4.07%</b>	<b>2.10%</b>	<b>2.10%</b>	<b>2.02%</b>

27. At 31st March 2020 the total liabilities were £193.159m which is below both the approved Authorised Limit and the approved Operational Boundary. The Operational Boundary is the point at which we expect borrowing to be, but it can be lower or higher. Borrowing cannot exceed the Authorised Limit.

28. A further four prudential indicators are detailed in **Appendix 1**.

### **Economic Background for 2019/20**

29. A summary of the general economic conditions that have prevailed through 2019/20 provided by Link Asset Services, the Council's treasury management advisors is attached at **Appendix 2**.

### **Summary of the Treasury Management Strategy agreed for 2019/20**

30. The revised Prudential Indicators anticipated that during 2019/20 the Council would need to borrow £11.366m to finance part of its capital programme.

31. The Annual Investment Strategy stated that the use of specified (usually less than 1 year) and non-specified (usually more than 1 year) investments would be carefully balanced to ensure that the Council has appropriate liquidity for its operational needs. In the normal course of the Council's business it is expected that both specified and non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

32. Longer term instruments (greater than one year from inception to repayment) will only be used where the Council's liquidity requirements are safeguarded. An estimate of long term investments (over 1 year) were included in the report on the Prudential Indicators update these were as follows £50m for 2019/20 and £50m for 2020/21. No other investments of over 1 year duration have been made during 2019/20.

### **Treasury Management Activity during 2019/20**

#### **Debt Position**

33. **Borrowing** – this increased during 2019/20 by £2.500m in total



	PWLB			Market Loans (incl. other Local Authorities)			Total
	Amount	Length of Loan	Interest Rate	Amount	Length of Loan	Interest Rate	
	£m		%	£m		%	£m
New Loans Taken							
	5.000	50 years	1.69%				
	5.000	50 years	1.69%				
				2.000	1 year	1.02%	
				3.000	1 year	1.02%	
				5.000	1 year	0.83%	
				5.000	3 months	0.70%	
				5.000	2 years	0.87%	
				5.000	9 months	0.80%	
				5.000	5 months	0.80%	
				5.000	1 year	1.00%	
							45.000
Loans Repaid							
				(5.000)	2 years	0.80%	
				(5.000)	1 year	0.70%	
				(5.000)	10 months	0.80%	
				(3.500)	1 year	1.00%	
				(5.000)	1 year	1.05%	
				(5.000)	1 year	1.15%	
				(4.000)	1 year	1.00%	
				(5.000)	1 year	1.10%	
				(5.000)	3 months	0.70%	
							(42.500)
Total New Borrowing	10.000			(7.500)			2.500

34. The new net borrowing of £2.500m was taken for various lengths of time at various interest rates as shown above.
35. **Summary of Debt Transactions** –The consolidated rate of interest decreased from 3.22% to 2.72% due to the above transactions.

### Investment Position

36. **Investment Policy** – the Council's investment policy for 2019/20 is governed by the DCLG Guidance which has been implemented in the annual investment strategy for 2019/20 approved by Council on 21 February 2019.
37. The investment activity during the year conformed to the approved Strategy and the Council had no liquidity difficulties.
38. Investments held by the Council consist of temporary surplus balances, capital receipts and other funds. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. These include investments in Money Market Funds, the Government's Debt Management Office and bank short term notice accounts. A total of 79 investments were made in the period 1 April 2019 to 31 March 2020 totalling c£146m these were for short periods of up to 100 days and

earned interest of £195k on an average balance of £27.354m which equated to an annual average interest rate of 0.70%

39. The Council also has longer term investments which consist of the property funds and the returns are shown below in **Table 6**.

**Table 6 – Longer Term 6 months to 5 years - Property Funds**

	<b>Original Budget 2019/20</b>	<b>Revised Budget 2019/20</b>	<b>Actual 2019/20</b>
Daily average level of Investments	<b>£29.999m</b>	<b>£29.999m</b>	<b>£29.999m</b>
Average Rate of Return on Investment (gross)	<b>3.57%</b>	<b>3.57%</b>	<b>3.44%</b>
Interest Earned (Gross)	<b>£1.072m</b>	<b>£1.072m</b>	<b>£1.033m</b>

### **Performance and Risk Benchmarking**

40. A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance, and these are shown in **Table 9**. Discrete security and liquidity benchmarks are relatively new requirements to the member reporting. These were first set in the Treasury Strategy report of the 25th February 2010.
41. The following reports the current position against the benchmarks originally approved.
42. Security – The Council’s maximum security risk benchmarks for the current portfolio of investments, when compared to historic default tables was set as follows:

#### **0.077% historic risk of default when compared to the whole portfolio**

43. **Table 7** shows that there has been a fluctuation in the historic levels of default over the year although still well below the benchmark. This is mainly due to some longer term investments actually being made for shorter terms i.e. up to six months rather than 1 year as these investments were better value than longer term investments and were also a better fit with how the council was expecting to utilise investments. It also shows more emphasis being placed on counterparties with a higher credit rating.
44. The investment portfolio was maintained within this overall benchmark during this year as shown in **Table 7**.

**Table 7**

<b>Maximum</b>	<b>Benchmark 2019/20</b>	<b>Actual June 2019</b>	<b>Actual October 2019</b>	<b>Actual January 2020</b>	<b>Actual March 2020</b>
Year 1	0.077%	0.002%	0.002%	0.001%	0.006%

45. The counterparties that we use are all high rated therefore our actual risk of default based on the ratings attached to counterparties is virtually nil.
46. Liquidity – In respect of this area the Council set liquidity facilities/benchmark to maintain
- (a) Bank Overdraft £0.100M
  - (b) Liquid short term deposits of at least £3.000M available within a weeks’ notice.
  - (c) Weighted Average Life benchmark is expected to be 146 days with a maximum of 1year.
47. Liquidity arrangements have been adequate for the year to date as shown in **Table 8.**

**Table 8**

	<b>Benchmark</b>	<b>Actual June 2019</b>	<b>Actual October 2019</b>	<b>Actual January 2020</b>	<b>Actual March 2020</b>
<b>Weighted Average life</b>	<b>146 days to 1 year</b>	<b>11 days</b>	<b>12 days</b>	<b>8 days</b>	<b>84 days</b>

48. The figures are for the whole portfolio of cash flow investments deposited with Money Market funds on a call basis (i.e. can be drawn on without notice) as well as call accounts that include a certain amount of notice required to recall the funds.
49. Yield - In respect of this area performance indicators relating to interest rates for borrowing and investments were set with reference to comparative interest rates. For borrowing, the indicator is the average rate paid during the year compared with the previous year. Investment rates are compared with a representative set of comparative rates.

**Table 9 – Performance Compared With Indicators**

<b>Borrowing</b>	Average overall rate paid compared to previous years	<b>2018/19 3.22%</b>	<b>2019/20 2.72%</b>
<b>Investments</b>		<b>DBC 2018/19</b>	<b>DBC 2019/20</b>
Short term	Cash flow investment rate returned against comparative average rate	0.68%	<b>0.69%</b>
Long term	Capital investment rate returned against comparative average rates	0.71%	<b>0.72%</b>
<b>Comparative rates used to compare DBC performance: -</b>			
<b>Comparative Rates</b>		<b>Short Term Investments</b>	<b>Long Term Investments</b>
Overnight Bid Rate Overnight		0.54%	-
London Interbank Bid Rate 7 day		0.53%	-
London Interbank Bid Rate 1 month		0.56%	-
London Interbank Bid rate 3 months		0.63%	-
London Interbank Bid rate 6 months		-	0.70%
London Interbank Bid rate 12 months		-	0.80%
<b>Average External Comparators</b>		<b>0.57%</b>	<b>0.75%</b>

50. As can be seen from the table, the actual investment rate achieved for short term investments exceeds the average of comparative rates whilst the longer term rate is roughly comparable with the comparator.

## Risk

51. The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:-

- (a) The Local Government Act 2003(the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity.
- (b) The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2017/18).
- (c) Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act.
- (d) The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities.
- (e) The SI also requires the Council to operate the overall treasury function with regard to the CIPFA code of Practice for Treasury Management in Public Services.

- (f) Under the Act the Department for Communities and Local Government has issued Investment Guidance to structure and regulate the Council's investment activities.
- (g) Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

52. The Council's Treasury Management function has complied with all of the relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low risk approach.

53. Officers of the Council are aware of the risks of passive management of the treasury portfolio and, with the support of Capita Asset Services, the Council's advisers, have proactively managed the debt and investments over the year.

### Treasury Management Budget

54. There are three main elements within the Treasury Management Budget :-

- (a) Long Term capital investments including Property Funds which earns interest, this comprises of the Council's revenue and capital balances, unused capital receipts, reserves and provisions.
- (b) Cash flow interest earned – since becoming a unitary council in 1997, the authority has consistently had positive cash flow. Unlike long term capital investments it does not represent any particular sum but it is the consequence of many different influences such as receipts of grants, the relationship between debtors and creditors, cashing of cheques and payments to suppliers.
- (c) Debt servicing costs – This is the principal and interest costs on the Council's long term debt to finance the capital programme.

**Table 10** Changes to the Treasury Management Budget 2019/20

	£m	£m
<b>Original Treasury Management Budget</b>		<b>0.425</b>
<b>Debt</b>		
Add increased interest payable on debt	<b>0.083</b>	
Less further savings on MRP	<b>(0.109)</b>	
Less reduced annual premium on rescheduled debt	<b>(0.163)</b>	<b>(0.189)</b>
<b>Investments</b>		
Less increased investment income including property funds etc		<b>(0.092)</b>
<b>Other Costs</b>		
Add increased brokerage charges		<b>0.013</b>
<b>Outturn Treasury Management Budget 2019/20</b>		<b>0.157</b>

55. The majority of the savings relate to a reduction in the annual premium on rescheduled debt some of which has been passported to HRA, although this has been offset by a reduction to the HRA of the interest payable on debt. There has also been an increase in the interest due on investments.

### **Conclusion**

56. The Council's treasury management activity during 2019/20 has been carried out in accordance with Council Policy and within legal limits. Financing costs have been reduced during the year and a saving of £0.268m achieved from the original MTFP.

### **Outcome of Consultation**

57. No formal consultation has been undertaken regarding this report.

## APPENDIX 1

## Additional Prudential Indicators not reported in the body of the report

		2018/19 Actual	2019/20 Approved Indicator	2019/20 Outturn
1	Upper limits on fixed interest rates ( <i>against maximum position</i> )	83%	100%	79%
2	Upper limits on variable interest rates ( <i>against maximum position</i> )	17%	40%	21%
3	Maturity structure of fixed rate borrowing ( <i>against maximum position</i> )			
	Under 12 months	17%	30%	19%
	12 months to 2 years	3%	40%	5%
	2 years to 5 years	10%	60%	9%
	5 years to 10 years	5%	80%	8%
	10 years and above	65%	100%	59%
4	Maximum Principal funds invested greater than 364 days	£30m	£50m	£50m

## The Economy and Interest Rates

**UK. Brexit.** The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Theresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

**Economic growth** in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the **coronavirus outbreak**. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in **quantitative easing (QE)**, essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in April and beyond. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

**Inflation** has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.



**Employment** had been growing healthily through the last year but it is obviously heading for a big hit in March – April 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

**USA.** Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Fed cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%. Near the end of March, Congress agreed a \$2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to \$6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of \$1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost \$367bn and 100% of the cost of lost wages for four months will also be covered. In addition there will be \$500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including \$50bn for airlines.

However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15 million by the end of March.

**EUROZONE.** The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs; this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

**CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

**JAPAN** has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It appears to have missed much of the domestic impact from coronavirus in 2019-20 but the virus is at an early stage there.

**WORLD GROWTH.** The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

## Glossary of Terms

Capital Financing Requirement (CFR)	This is the Councils underlying need to borrow which can be traced back to the Councils Balance Sheet and the value of the Councils assets which have yet to be paid for.
Minimum Revenue Provision (MRP)	Monies set aside from the revenue budget to repay accumulated debt.
Call	Investments that can be returned without a period of notice
Counterparty	Institutions, Banks etc. that with make investments or take out loans with.
Specified Investments	Investments in Banks and Building Societies with a high credit rating for periods of less than 1 year
Non-Specified Investments	Investments in un rated Building Societies and any investments in Banks and Building Societies for more than 1 year.
Operational Liquidity	Working Cash flow
Authorised Limit	Maximum amount of borrowing that could be taken in total.
Operational Boundary	The expected amount of borrowing assumed in total.
PWLB	Public Works Loan Board. The Governments lending body to Local Authorities
Discount	Amount payable by the PWLB when loans are repaid if the current loan rate is less than the rate borne by the original debt
Yield Curve	Is a graph that shows the relationship between the interest rate paid and length of time to repayment of a loan.
Gilts	Government Borrowing Bonds
Spreads	The difference between the highest rate of interest and the lowest rate of interest earned/charged on any one particular maturity period i.e. 1 year, 2 year 5 year etc.
LIBID	London Interbank Bid Rate. The average rate at which a bank is willing to borrow from another bank.
LIBOR	London Interbank Offer Rate. The average rate at which a bank is willing to lend to another bank. LIBOR is always higher than the corresponding bid rate and the difference between the two rates is known as the spread.